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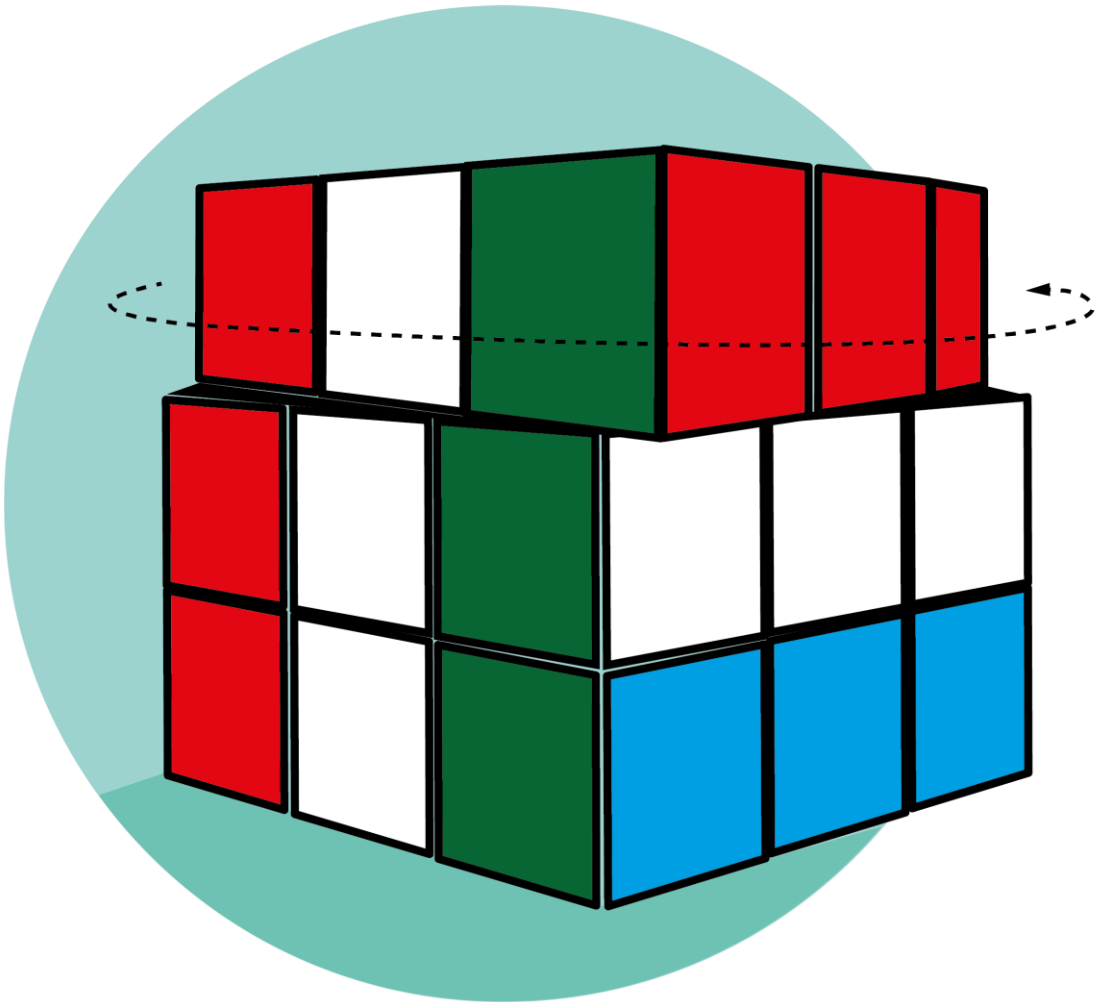

Asset Management in Italy:
a snapshot in an evolutive context

Executive Summary

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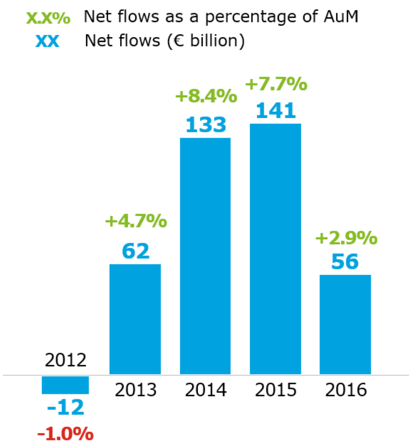


Net Flows into the Asset Management Industry (2012-2016)

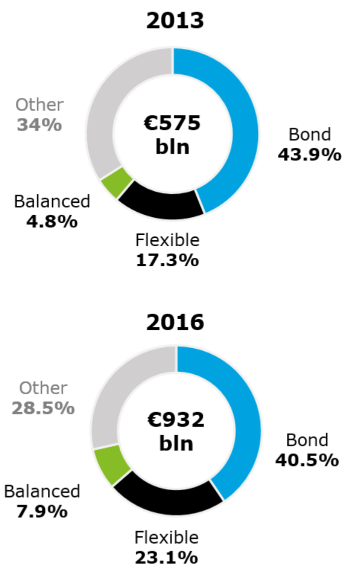
The industry has been growing thanks to positive net flows. 2014 and 2015 have been two exceptional years, with net flows over one hundred billion Euros.

The Italian asset management industry is experiencing an extended period of growth and is now one of the largest and most dynamic across Europe. Over the last four years, funds and portfolio mandates have, with very few exceptions, recorded positive monthly flows, marking a truly flourishing period for asset managers and distributors. Low interest rates have for the first time forced Italian savers and institutions to look beyond the easy returns that in the past were guaranteed by Government bonds, bringing favourable news to asset managers. Nonetheless, the pace of change has dramatically intensified, triggering challenges and opportunities for incumbent and new players.

Market Overview

Funds are becoming more and more popular across investors thanks to the diversification that they allow and to the professional competence of financial operators. Multi-asset products have overtaken traditional equity and bond funds, with the rise in the most recent years of balanced and flexible funds, which now accounts for 31% of the value of funds distributed in Italy. In this context, asset managers tend to provide solutions with a goal-based approach rather than merely offer investment instruments. In this context, the recently introduced Piani Individuali di Risparmio (PIR) are gaining momentum and, in addition to foster a new financing wave to Italian companies, are deemed to blow fresh air into the industry. In fact, experts are confident that several billions of new flows to the industry will be generated through PIR in the next five years.

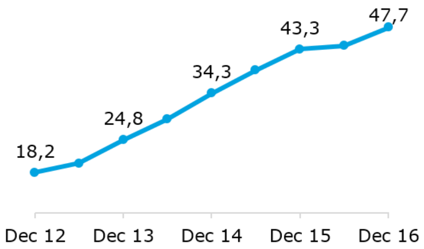
Furthermore, after a decade of negative flows, Italian-domiciled funds have regained their popularity over the last four years, thanks to some improvements in the Italian fiscal system as well as to the Italian banks' positive attitude towards funds, fostered by the declining need to raise liquidity through the placement of bonds to retail people.



Funds distributed in Italy by asset class

Balanced and Flexible funds have registered a significant growth between 2013 and 2016, whereas Bond funds, despite remaining the leading category, in the same period have experienced a slow decline.

In addition, ETFs, although representing a minor component in the industry if compared to other countries, have experienced a steady growth in the Italian market. The volume of assets managed within them surged to €47.7 billion (at the end of 2016) starting from € 18.2 billion only four years before. It is still not clear whether passive management will achieve success in the future.



ETFs traded at the Milan Stock Exchange (AuM, € billion)

As a matter of fact, despite some industry leaders believe that passively managed funds will dominate the future scenario, the prevailing opinion is that the market evolution will favour active funds thanks to the superior performance that they will likely allow. Yet, we find that, in general, active funds tend to be outperformed by their passive counterparts and this effect is more marked for longer time-horizons.

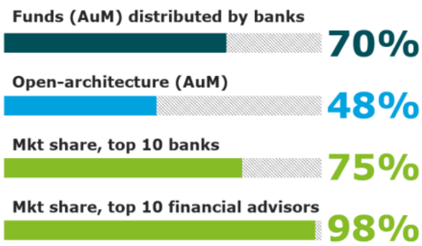
Coming to market players, we see that achieving scale efficiency and critical-mass seems to be one of the biggest concerns for Italian asset managers. Even though the five biggest players control around 59% of Italian AuM, we expect a wave of consolidation and further concentration in the industry caused by the increase of the minimum dimension needed to be profitable. In fact, companies positioning under the threshold will incur in many obstacles like the increasing competitive pressure and low economies of scale for operating and distribution costs while low rates and compliance costs will in general reduce returns.

Fund and Life Insurance Distribution

Retail investors play a fundamental role in the fund industry: 85% of funds distributed in the Italian market are held in their portfolios. Numbers highlight the relevance of distribution, since funds for around half a trillion Euros are directly sold to Italian savers through the distribution network, which is characterized by some unique features:

CENTRALITY OF BANKS

Banks dominate Italian distribution. They are leaders in both fund and life distribution, placing around 70% of funds to retail people and collecting the largest share of life insurance premiums, which account each year for more than a hundred billion Euros. The remaining 30% pertains to financial advisors networks, which also play an important role in the penetration of foreign asset managers in the Italian market.



OPEN ARCHITECTURE

If compared to other European countries, Italy shows a more open distribution architecture. When considering also Funds of Funds, 48% of AuM is placed by a distributor which does not belong to nor have strategic partnerships with the fund house. However, industry expert expects the architecture to become more closed in the future due to the increasing costs needed to manage the relationship between players positioned at different stages of the value chain.

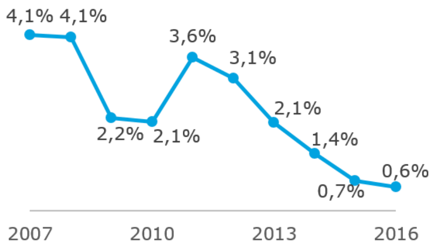
CONCENTRATION

The market is highly concentrated: the first ten banks place together 75% of funds distributed in Italy and the top ten networks of financial promoters are able to place 98% of funds among retail people.

VERTICAL INTEGRATION

The relationship between Italian asset managers and distributors is mainly captive, with a high level of integration between the "manufacturer" and the distributor. This evidence does not hold for foreign asset managers, which generally do not have an owned distribution network in Italy and rely upon banks and financial advisors scattered throughout the territory.

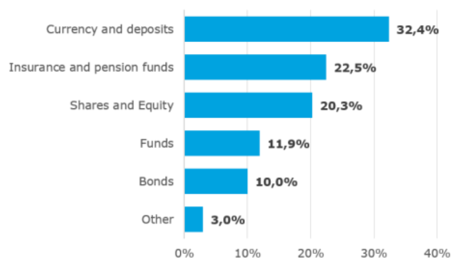
Several changes are expected for the future, caused by the incoming regulation and by tech innovations. Among them, costs for compliance as well as competition will likely increase, thus triggering a consolidation wave to remain profitable over the medium-term.



Average Interest Rate of Italian Government Bonds

60%

Clients of the Asset Management industry belonging to the **Baby Boomers** generation



Breakdown of Italian houseolds' portfolio (2016)

The Demand Side

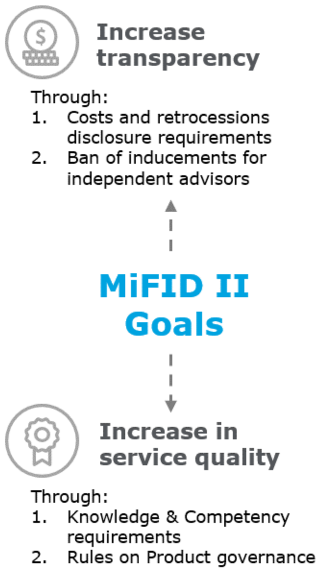
Italians are great savers. Despite their conservative financial habits, they have been forced to consider other investments than government bonds and deposits. It is of crucial importance to dig deep into their specific investment needs: low risk seekers and poorly financially educated, Italians need to have a personal relationship with their advisor. As a matter of fact, according to the S&P Global Financial Literacy Survey, Italy was the worst performer among G7 countries regarding financial education. On the other hand, the positive relationship between the number of bank branches/financial promoters and the participation rate of the population in domestic funds suggests that demand is actually driven by offer: where there is a closer relationship with the financial promoter, savers have more developed attitudes towards investments.

Baby Boomers, who represent the demographic group born in the two decades after World War II, are the main target for the industry. The Italian senior savers represent 37% of the Italian population but 60% of the clients of the Asset Management industry and they own 63% of the AuM.

Finally, the Italian household's portfolio, deeply affected by the recent crisis, is very peculiar. One third of Italians' financial wealth is still parked in deposits and cash, representing an untapped potential for the asset management industry, that in the future will need to move these resources within its boundaries.

Regulatory Challenges

In the past few years, regulatory compliance has constantly been at the top of asset managers' agenda. Currently, the most debated regulation is the upcoming Market in Financial Instruments Directive (MiFID II), as it covers many areas of the industry and brings relevant challenges to the table. The Directive sets two main objectives: making the system more transparent and improving service quality.



MORE TRANSPARENCY

Regulators have imposed costs and retrocessions disclosure requirements and banned inducements in the case of independent advisory. While everyone agrees that transparency is a fundamental right of all investors, players in the industry seem a little concerned about the corresponding requirements. Clients will be fully aware of the cost structure of their investments, pushing the quality - real or perceived - of the advisory service to increase in order to justify the premium charged. More time and resources will be needed to achieve higher quality, hence calling for greater productivity.

On the other hand, the ban on inducements for independent advisors does not seem to bring any revolutionary changes since the majority of advisors appear determined to simply take the non-independent pathway. Although it can not be excluded that some opportunities could open up for a specific segment of investors willing to pay directly for advice, this is expected to remain a limited phenomenon.

HIGHER QUALITY OF ADVISORY

MiFID II also introduces standards on product governance and imposes minimum qualifications to agents wanting to operate as financial advisors. Product governance requirements do not represent an issue themselves; indeed Italian operators have already adopted many of these standards under CONSOB. Yet, they cast a shadow on firm’s margins due to the costs deriving from the continuous exchange of information that will have to take place between producers, distributors and clients.

~200,000

Bank employees that need to be certified according to the provisions set forth by MiFID II

Knowledge and competency requirements, on the other hand, do not seem to raise too much concern among Italian operators as many believe that the model currently in place is already compliant with the Directive. However, this is a pain point for banks: many bank tellers do not meet any of the MiFID II requirements. For this reason, financial institutions will have to quickly find a way to fill the gap and make their advisors compliant.

Overall, most operators declare to be sufficiently ready to implement the aforementioned changes. Yet, this does not mean that there will not be unexpected consequences ahead for some players, especially for the smallest ones, who will find handling compliance somewhat burdensome.

Digital (r)evolution in Asset Management and Fund Distribution

Technology developments are revamping asset management in many ways.

REGTECH

RegTech, or Regulatory Technology, represents a relatively new opportunity in the financial service industry that emerged as an innovative answer to the big wave of regulatory provisions seen in these past few years. On the one hand, RegTech provides solutions for compliance operations through technological innovations. On the other hand, it creates a new opportunity for business development. Indeed, by using RegTech, AM operators can not only economize time and costs, hence leaving managers with more room to focus on the core business but also make data exploitable for other business purposes thanks to advanced analytics and data mining tools.

ROBO ADVISORY, ARTIFICIAL INTELLIGENCE AND SOCIAL MEDIA

Services currently offered by Robo-advisors

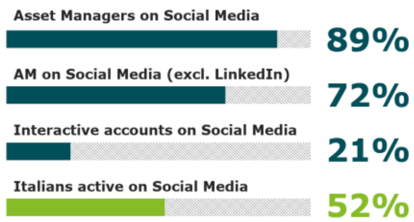
- **Know Your Client**
- **Anti Money Laundry**
- **Compliance checks**
- **Rebalancing of portfolios**
- **Investment allocation**

To meet investors' new demands, financial institutions need now to reach their customers through a wide variety of channel, enabling them to carry out transactions in every moment and from any place. In this context, robo-advisory can be a key instrument both in the hands of investors - with a *Direct-to-Consumer* model - and of advisors - with *Robo4Advice* platforms. The range of products is wide and goes from ETFs to traditional stocks and bonds. Together with the rise of new opportunities of accessing new markets, automatising processes and taking advantages from economies of scale, players face the risks of cannibalisation and of a downward pressure on fees. With hundreds of millions of assets under management, the phenomenon in Italy is rising significantly, but it is still far from the size of the UK or the US. Italian players operate mainly locally and are impacting mostly the mass affluent segment, though remaining slightly more expensive than their Anglo-saxon counterparts.

60+
players in Europe

€ 3 trillion
addressable market in Europe

Robo-advisory is only one element of a larger wave of technological innovation. Artificial Intelligence, for example, opens a handful of implementable services in the asset management industry, from chatbots that answer customers' demands in real time, to complex risk management models to implement better strategies. Competition in the arena is getting fiercer and fiercer, and not only among the well-known American behemoth companies. In fact, startups all around the world are making their first steps in this new field. In addition, many established players are investing massively in Artificial Intelligence either by hiring computer and data scientists to develop software in-house or directly by acquiring FinTech companies. Even though the possible applications are



almost unlimited, Artificial Intelligence will unlikely completely replace humans, but will rather be a strong ally to make sounder investment decisions.

Not only software for CRM and financial modelling, but also social media are having an increasingly important impact in asset management due to the fundamental role they play in the modern investment community. 89% of asset managers have already appeared on social media, although only a few employ this technology to actively communicate with their customers. In Italy, the social network penetration has proved to be impressive considering the cultural background of the country, reaching 52% of the population. The opportunities brought by the new role of social media in the industry include mining social channel that, along with the use of sophisticated analytical tools, could represent a valuable tool for asset managers. While relatively small at this stage, there is a number of emerging models who make use of technology, data, social networks and communities to bring fresh propositions to the market.

BLOCKCHAIN

Blockchain represents another opportunity for the asset management industry. The new technology is able to automatically and transparently record transactions in distributed and digital ledger and to perform smart contracts without the need for a centralized trust authority. It carries a tremendous potential for innovating the way in which the industry works. Blockchain can be applied in different functions and departments such as settlements, fund validation, reporting and data management. Any kind of intermediation that involves activities like recording or executing transactions are likely to be replaced by the new technology.

Its implementation in the asset management business is likely to bring many benefits. Blockchain is thought to be able to improve reporting accuracy, provide timely and accurate information, reduce delays and finally result in huge cost cuts. The final beneficiary of the implementation of Blockchain will be the investor: reduced costs and huge improvements in the quality of the information on investment will enable a much better service provided by asset managers.

The full paper can be requsted to Deloitte Luxembourg on the webpage dedicated to the Italian Business Community: www.deloitte.com/lu/italian-business-community

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